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## CRITICISMS OF THE PROPOSED FEDERAL RESERVE BANK PLAN<sup>1</sup>

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THE administration's currency bill as it now stands in the Senate embodies many features that are fundamentally sound and consonant with the best traditions of banking theory and practise; such, for example, as the creation of a central bank with branches, the recognition of bank assets in the form of commercial paper as the normal and proper basis for bank-note currency, and the provision for the keeping of the current funds of the government in active use instead of locking a large part of them up in the sub-treasuries. Despite these great merits and the substantial improvements that have been made in the bill by recent amendments, it still contains certain glaring defects which threaten its permanent usefulness. Inasmuch as helpful criticism of the defects of the measure rather than commendation of its merits is what is needed at the present time, I shall confine the brief time at my disposal to a consideration of the chief of these defects.

While a central authority has been created with more power than we should have expected the government to give to a central bank, the measure is defective in that it creates twelve central banks. Although it has been the commendable purpose of the bill to mobilize reserves and to prevent that scramble among banks for reserve money in times of danger which has been the bane of our present decentralized banking system with its rigid reserve requirements, this purpose clearly cannot be realized by the creation of twelve separate institutions. The method resorted to would divide the cash reserves of the country into as many different ownerships as there

<sup>1</sup>Read at the meeting of the Academy of Political Science, October 14, 1913.

are regional associations, thus nullifying the true aim of this whole measure.

No individual bank can now strengthen its cash reserves without at the same time and to the same extent depleting the reserve of some other bank, except by the importation of gold or by the occasional receipt of funds from the United States treasury. In the same way, no one of the regional reserve banks will be able to strengthen its cash reserves without drawing from and reducing to the same extent the reserve of one of the other banks, unless it imports gold. Government funds will all be in these regional banks. There will inevitably be competition among the regional reserve banks and among the twelve sections of the country in time of money stringency, just as to-day under similar conditions each of the twenty-nine thousand banks begins competing with the others to strengthen its cash reserves. Furthermore there is the possibility that this condition would exist among the individual banks as well. It appears that the framers of the measure realized the danger; but that they failed to meet it is shown by the provision authorizing the Federal Reserve Board arbitrarily to force one reserve bank to loan to another. This seems an open confession of the inability of the system automatically to adjust itself to the needs of the country. This shifting of funds could hardly be accomplished without ostentation and without notoriety; if the Federal Reserve Board should require, as it might do under this proposed law, one federal reserve bank to loan money to another, that could not be done without attracting attention to the borrowing locality in a way that would operate to the prejudice of that locality. There is strong probability that in exercising the authority to compel such a loan, the Federal Reserve Board would create a distrust that would endanger the smooth working of the whole plan.

It is wisely and properly provided that the regional reserve banks may extend their activities through the establishment of branches, providing only that the number of branches shall not exceed one for every \$500,000 of capital of the federal reserve bank of which the branch is a part.

Would it not be far better if the law should create one central bank with branches wherever there is commercial need for them? Would not such a plan be simpler, less cumbersome and more efficient than the present plan of granting the Federal Reserve Board power to direct one section of the country to loan money to another? With all deposits in one central bank, they would naturally flow to the localities where most needed. Should danger arise at some point in our vast fabric of credit, would not one vast reserve be much more powerful to overcome it than twelve smaller reserves?

Under the proposed law the country is divided up into twelve districts, each to have a federal reserve bank and all to be under the general control of the Federal Reserve Board. That board is to consist of seven members—the Secretary of the Treasury, Secretary of Agriculture, comptroller of the currency, and four others to be appointed by the President and Senate, only one of whom must needs have had banking experience. The most serious objection to the organization of the board lies in the method of selecting its members. That a board so appointed would be dominated and controlled by political expediency is obvious. The three *ex-officio* members would owe their positions to their political affiliations, if not to their political activities. That the framers themselves recognize the difficulty of keeping the other four appointments free from party connection is shown in the provision stipulating that not more than two of the members should be selected from the same political party. Subjected as they are to all the whims of party favoritism, the members have not that attribute of independence that should attach to a board of this character. Its members, with a single exception, need have no previous experience in, or knowledge of, the banking business, the destinies of which are to be placed in their hands—a proposition which is its own best commentary upon their qualifications for handling intelligently so delicate a mechanism.

The Federal Reserve Board by its very nature will be nothing more nor less than a department of the administrative branch of the government charged with the direction and

control of the banking destinies of the country. In the event of a district desiring some special favors at the hands of the Federal Reserve Board, it would be in a position to make use of present political methods to secure the influence of senators and representatives in favor of that particular district. The banking community, as a class, has no representative on the Federal Reserve Board. This, together with the additional fact that, as a class, bankers have only a minority representation on the boards of the regional banks themselves, makes it manifestly unjust to require the banks to surrender so large a portion of their resources to the regional banks. To some extent, the regional banks will be competitors with the banks for business. Is it not going too far to expect that the banks should furnish one-fifth of their capital to an institution which will be a competitor?

National banks, and trust companies in New York, are required to make certain investments as a condition precedent to incorporation. Never before has it been specifically directed what investments going banks shall make; as, for example, that all national banks should invest twenty per cent of their capital in federal reserve bank stock, or that one regional bank should loan to another regional bank. Such legislation is clearly an invasion of the field of credit. Never before has such a power been conferred on any central bank. If the government may direct the disposition of a bank's resources to a limited extent, the question may well be raised whether it may not dispose of these resources in their entirety. Banks operating under charters, which have ever been regarded in the nature of a contract, are hereby forced to make this subscription, and it is doubtful if under our constitution Congress can take away the charter of a bank in this summary manner, because of the bank's refusal to make a coerced investment. This proposition of the government to take the bank's capital in the manner provided, carried to the extreme, might easily accomplish, so far as national banks are concerned, one of the fundamental tenets of socialism and transfer ownership to the government.

The Federal Reserve Board will have power to issue treas-

ury notes to the federal reserve banks upon the segregation of specified current assets of such banks as security. In addition to parting with its assets to an amount equal to the notes received, a federal reserve bank will have to maintain a  $33\frac{1}{3}\%$  gold reserve against such notes. The redemption of these notes becomes further a prior lien upon all the assets of the bank to which they have been issued. All this security would seem to make the notes good without necessitating the further obligation of the government. There appears no justification for creating a situation by which at some future time the credit of the government might be imperiled. With the balance of trade against us, making gold shipments necessary, a general crop failure, or war, the reserves of these federal reserve banks might be reduced below the point of safety. Whenever their reserves were brought to a point that warranted any criticism, the credit of the government itself as to its ability and purpose to redeem all notes in gold upon presentation would be called in question.

Should the proposed policy of treasury notes be adopted, and the obligations of the government immediately redeemable in gold thus be largely increased, there would be every reason to apprehend, under similar circumstances, a repetition of our experience of 1893, when our national credit was subjected to so severe a strain.

The government should unquestionably coin and furnish metal money; that is, the money of ultimate redemption, but the experience of the world proves that paper currency, redeemable in metal money, may better be furnished through a bank like the Bank of France or the Reichsbank of Germany, separately incorporated, under strict government control or regulation, but possessing current assets which have an everyday market at a price, and upon which it may at any time, if need be, realize. The provision making the government responsible for the treasury notes to be issued is fundamentally wrong, and this policy will inevitably invite future disaster.